

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

COMPLETED

56

Pension Losses Of Contractor Employees At Federal Installations Can Be Reduced

Contractor employees at Federal installations have lost, and will probably continue to lose, pension benefits because their employers change even though their jobs do not. Contracts are often for less time than is needed for employees to obtain a nonforfeitable right to pension benefits, and new contractors do not usually give credit for service with prior contractors.

The Departments of Energy and the Army have acted to help ensure that pension benefits are protected when they select new contractors. However, there is no Government-wide policy regarding the pensions of contractor employees who work at Federal installations. If the Congress desires, a uniform policy can be developed to help protect these long-term employees.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses how some contractor employees lost pension benefits, although they continued to work at Federal installations, because contractors were replaced. Government-wide adoption of pension protection arrangements similar to those used by the Department of Energy could reduce such losses.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretaries of Defense, Energy, and Labor; and the Administrator, National Aeronautics and Space Administration.

Milton J. Fowler

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

PENSION LOSSES OF CONTRACTOR
EMPLOYEES AT FEDERAL INSTALLA-
TIONS CAN BE REDUCED

D I G E S T

The Government contracts with service contractors who provide specified services at Federal installations and with operating contractors that generally have responsibility for operating Government-owned facilities.

There is no Government-wide policy regarding whether, or to what extent, Federal agencies should attempt to protect the pension benefits of contractor employees working at Federal installations. Although most workers on the Federal service contracts that GAO reviewed were covered by pension plans, many have lost pension benefits because their employers have changed even though their jobs have not. These losses are likely to continue.

GAO made the review because the Congress has shown concern about the pensions of employees working on Government contracts and the fringe benefits of service contractor employees. (See p. 1.)

MANY SERVICE CONTRACTOR
EMPLOYEES UNLIKELY TO
RECEIVE PENSION BENEFITS

Pension plans were not available to many employees working on service contracts. Even when the Department of Labor included pension benefits in its determinations of fringe benefits applicable to service contractor employees, some contractors chose to pay the cash equivalent of pension benefits, rather than establish pension plans, as permitted by law. Also, some employees chose not to participate in pension plans.

Although pension plans were available to most service contractor employees, many of them will receive no benefits or reduced benefits from these plans because they do not work for the same employers long enough to be vested in their pension plans. (A vested employee is one who has a nonforfeitable

right to pension benefits.) The Employee Retirement Income Security Act provides minimum vesting standards for pension plans. However, none of the minimum vesting standards require that employees be even partially vested in pension plan benefits with less than 5 years of service. Many pension plans provide for full vesting after 10 years of service, with no vesting for less than 10 years, as permitted by the act.

GAO examined the pension status of employees working on 16 service contracts and found that 65 percent of them had no vested right to pension benefits although over 29 percent had 5 or more years service at the same Federal installation. Also, some of the vested employees received less benefits than if all their service had been with one contractor because they were not vested or were only partially vested with some contractors.

Service contracts of the National Aeronautics and Space Administration were a large part of GAO's sample. Numerous employees were identified who had worked on service contracts for long periods of time and were not vested or were only partially vested because contractors had changed. Many of these employees were working for contractors that had 3-year contracts and pension plans which required 6 or more years for any vesting, and that did not give credit for service with prior contractors. (See p. 10.)

Earlier or immediate vesting could help improve employees' pension benefits. However, reducing the time required to vest would increase costs and/or reduce benefits to long-term workers. Also, reduced vesting periods do not necessarily assure retirement benefits because employers may pay terminating employees a lump-sum equivalent of future pension benefits. Such payments may be spent rather than saved for retirement. In instances where such payments were made, some employees spent the money, and others did not plan to use it for retirement. (See pp. 5 and 17.)

SOME PENSION BENEFITS HAVE BEEN PROTECTED

For the major operating contracts that GAO identified, in most cases the same contractors had been operating the facilities for long periods of

time. Even when contractors changed, employees' pensions were protected.

The Department of Energy has special pension arrangements for its cost-type operating contracts to help ensure that employees' pension benefits are protected when contractors are replaced. These arrangements stress continuity of pension coverage and discourage employees from withdrawing contributions. GAO reviewed three contracts where contractors had changed and found that employees' pension benefits had been protected. The Department's special pension arrangements also apply to some contracts that appear to be more like service contracts than operating contracts.

Two of the three Army facilities had been operated by the same contractors for over 25 years. When contractors changed at the third facility, the employees' pension benefits were protected. An Army official said that his command's policy was to encourage successor contractors to make allowance for continuity of service. He provided an example of another facility where the new contractor continued the employees' pension plan. (See pp. 7 and 18.)

RECOMMENDATION TO THE CONGRESS

If the Congress determines that the pension benefits of contractor employees who work for long periods of time at Federal installations should be protected, GAO recommends that it direct the Administrator for Federal Procurement Policy to establish a Government-wide policy and implementing regulations to help ensure such protection. GAO believes that the Department of Energy's pension protection arrangements, which emphasize pension portability and discourage lump-sum payments in place of future retirement benefits, would provide a good model for such a policy. To minimize administrative problems, if such a policy is adopted, it should be limited to relatively large negotiated contracts where a long-term need for future services is foreseen.

To ensure that any policy and regulations developed are consistent with congressional intent, the Congress could establish oversight provisions.

AGENCY COMMENTS

The Office of Management and Budget said that, if the Congress were to determine that pension benefits at Federal installations should be protected, its Office of Federal Procurement Policy could establish a policy and implementing regulations to help ensure such protection. It also said, and GAO agrees, that any policy considered should carefully protect the Government against claims from contractor employees for unpaid or disregarded pension rights. (See p. 23.)

The Department of Labor said the proposed pension protection arrangements encourage the transfer of service credits and pension funds to successor contractors' plans. Labor said this could cause serious administrative problems for the successor plans, would significantly increase administrative costs, and may not be feasible in some cases. Labor also said that GAO's recommendation tended to discount the significantly increased costs to the Government for accelerating the vesting of workers.

GAO agrees that transferring service credit and pension funds may not always be appropriate or feasible. However, the Department of Energy's pension protection arrangements provide alternative methods in such cases and these arrangements have worked. GAO's recommendation does not involve reduced vesting times. Recognition of service with replaced contractors would increase the number of employees who vest and, thus, result in increased costs. However, if the size of contracts and the percentage of non-vested long-term employees identified during GAO's review are typical, GAO's recommendation would affect only a relatively small percentage of contractor employees working on Government installations. (See p. 24.)

The National Aeronautics and Space Administration believed GAO's findings were not limited to Federal contractor employees and, because of the national implications of the subject of pension benefits, an equitable solution could not be achieved through Federal procurement policy alone.

GAO believes actions to address the vesting problems of contractor employees working at Federal installations need not await resolution of the national problem. (See p. 27.)

The Department of Defense agreed with GAO's recommendation, if it is the will of the Congress. (See p. 27.)

The Department of Energy chose not to comment on GAO's report.

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ABBREVIATIONS

AEC	Atomic Energy Commission
DOE	Department of Energy
ERISA	Employee Retirement Income Security Act of 1974
GAO	General Accounting Office
NASA	National Aeronautics and Space Administration
OMB	Office of Management and Budget

CHAPTER 1

INTRODUCTION

The inability of workers to transfer pension benefits when they change jobs has been recognized as a problem in the mobile U.S. work force. Federal agencies make regular use of contractors to provide continuing services at Federal installations. This report primarily deals with workers who change employers without changing jobs because the Government selects new contractors.

THE SERVICE CONTRACT INDUSTRY

The service contract industry emerged in the early 1950s, when the Government began to contract for services previously performed by Federal employees. The Government furnished the facilities and the contractor furnished the employees.

As the industry grew, the pricing of contracts became intensely competitive, and contractors had an incentive to reduce labor costs. As a result, contractor employees frequently received much lower pay than the Federal employees they replaced. Also, contractors often underbid a contractor paying the area's prevailing wage.

These conditions led to the enactment of the Service Contract Act of 1965 (41 U.S.C. 351, et seq. (1976)) to protect employees working on Government service contracts from "wage busting"—the practice of lowering employee wages and fringe benefits by either incumbent or successor contractors in an effort to receive contracts.

The act, as amended, covers all employees who work on service contracts except bona fide executive, administrative, and professional employees. The Department of Labor, which administers the act, has determined that employees of prime contractors which have been delegated the responsibility for all work to be done relating to the operation and management of a Government facility on a cost-reimbursable basis, together with the authority to obligate Government funds in the procurement of all services and supplies necessary to carry out the entire program of operation, are not subject to the act.

The act requires that employees receive at least the minimum wages specified under the Fair Labor Standards Act of 1938, as amended (29 U.S.C. 201). For contracts exceeding \$2,500, the minimum wages and fringe benefits must be based on rates Labor determines as prevailing for service employees in the locality, or based on collectively bargained rates of the predecessor contractor, if any.

Contractors' obligations to pay fringe benefits (including pensions) may be discharged by furnishing equivalent combinations of fringe benefits or by making equivalent payments in cash instead of providing the benefits specified by Labor.

Although the services provided may be needed indefinitely, the length of service contracts is limited. The act permits service contracts to be awarded for up to 5 years if they include provisions for the periodic adjustment of wages and fringe benefits at least every 2 years.

Operating contracts

The Government also uses operating contractors who generally perform complete management and operations of Government-owned facilities. As discussed above, Labor has determined that operating contracts meeting certain requirements are not subject to the act. However, service contracts awarded by operating contractors would be subject to the act.

CONCERN ABOUT EMPLOYEES' PENSIONS

The Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1001) was enacted on September 2, 1974, because of indications that pension plan misuse and abuse were resulting in lost pension benefits to employees even after long years of service. The purpose of ERISA is to make sure that participants in private pension plans receive earned benefits. Favorable tax treatment is provided to pension plans, their sponsors, and participants, if the plans meet ERISA and related Internal Revenue Code requirements.

To protect the interests of employees, ERISA established comprehensive minimum standards and requirements that specify how employees become eligible to participate in pension plans (participation standards) and how employees earn a nonforfeitable right to pension benefits (vesting standards). These standards and requirements were established so that employees do not have to work an unreasonable number of years before participating in and benefiting from a private pension plan.

ERISA provides that, generally, employees must be allowed to participate in pension plans after they are 25 years old and have completed 1 year of service.

ERISA provides that participants of pension plans have a vested right to retirement benefits upon reaching the plans' normal retirement age. ERISA also provides that participants have a full and immediate vested right to accrued benefits resulting from their own contributions to a plan even if they terminate employment before

retirement. Regarding accrued benefits resulting from employer contributions, ERISA requires that one of the three following minimum vesting standards be met or exceeded.

--An employee is 100 percent vested at 10 years of covered service (commonly referred to as the "10-year cliff" vesting schedule).

--An employee is 25 percent vested at 5 years of covered service, increased by 5 percent for each year of service from years 6 through 10, then increased by 10 percent each year until 100 percent vested.

--An employee is 50 percent vested after at least 5 years of service when age plus covered service equals 45, with specified vesting increments for further increases in age and service. However, an employee must be at least 50 percent vested after 10 years of service, increased by 10 percent each year until 100 percent vested.

While partial vesting provides some protection for the pensions of employees who change employers, it usually will result in lesser benefits than if all service were with the same employer. For example, assume that three different employers have identical pension plans which provide vesting as follows:

<u>Years of participation in plan</u>	<u>Percent vested</u>
Less than 6	0
6 but less than 7	20
7 but less than 8	40
8 but less than 9	60
9 but less than 10	80
10 or more	100

Assume that an employee worked for 20 years and would normally be entitled to a pension of \$5 each month for each year of service. Depending on how many of the three employers the employee worked for and the employee's length of service with each employer, the employee's pension benefits would be as follows.

Worked for one employer

20 years X \$5 per month = \$100 X 100 percent vested = \$100

Worked for two employers--Employer A for 8 years,
and Employer B for 12 years

From Employer A:

8 years X \$5 per month = \$40 X 60 percent vested = \$24

From Employer B:

12 years X \$5 per month = \$60 X 100 percent vested = 60

Total

\$84

Worked for three employers--Employer A for 3 years,
Employer B for 6 years, and Employer C for 11 years

From Employer A:

3 years X \$5 per month = \$15 X 0 percent vested = \$ 0

From Employer B:

6 years X \$5 per month = \$30 X 20 percent vested = 6

From Employer C:

11 years X \$5 per month = \$55 X 100 percent vested = 55

Total

\$61

ERISA also provided that employees not covered by employer-sponsored pension plans can establish Individual Retirement Accounts. ^{1/} There are two kinds of accounts--the basic and the rollover. The amount contributed to the basic account is deductible from the employee's gross income, reducing taxable income for the year. The money is taxed when it is withdrawn. Rollover accounts are for people who leave their jobs or retire and receive a lump-sum profit sharing or pension benefit. Employer contributions in this payment would normally be taxed in the year paid. However, the taxes can be deferred if the money is deposited into an Individual Retirement Account within 60 days.

There has been much concern about the inability of employees covered by pension plans to obtain a right to benefits because of job changes in the highly mobile U.S. work force. On September 5,

^{1/}Recently enacted legislation will permit employees covered by employer-sponsored pension plans to establish Individual Retirement Accounts.

1980, Labor reported that a contractor-performed study ^{1/} showed that, during 1980-82, 6.7 million employees from 25 to 61 years old who are covered by private pension plans will change jobs. Two-thirds of them are estimated to lose accrued pension benefits because they will not be vested.

Proposals have been made to help individuals retain accrued pension benefits through shorter or immediate vesting and/or portability. On February 26, 1981, the President's Commission on Pension Policy, which examined the Nation's retirement, survivor, and disability systems, submitted its final report "Coming of Age: Toward A National Retirement Income Policy." The report contained a number of recommendations and suggestions, including

- the establishment of a minimum universal pension system with immediate vesting of benefits, and a mechanism for portability of benefits;
- voluntary reductions in vesting schedules for pension benefits above the proposed minimum; and
- the prohibition of payments of over \$500 in lieu of future pension benefits unless such payments are to be transferred to an Individual Retirement Account or to the pension plan of a subsequent employer.

Objections have been made to quicker vesting on the bases that it would be administratively costly, increase employee turnover, reward short-term employees at the expense of long-term employees, cause pension plan terminations, and discourage the starting of new plans. Also, the earned benefits of short-term employees would be generally small, and employers would tend to pay the terminating employee the cash value of benefits. Such cash payments may be spent rather than saved for retirement.

The Employee Benefit Research Institute issued a report in December 1980 entitled "Analysis of Alternative Vesting Requirements for Private Pensions." The report shows that, although shorter vesting schedules would increase the number of workers who would receive a payment from a pension fund, even under a plan with full and immediate vesting, the estimated present value of pension benefits for workers with 9.5 or less years of service and under age 37 would be less than \$1,750. ERISA permits an employer to pay out terminating employees' benefits valued at less than \$1,750 rather than keep the employees in the pension plan. Plans frequently make such payments and employees may spend them.

^{1/}Brandeis University. "Private Pension Policy Simulations." Available from National Technical Information Service, Springfield, Va. (Specify No. PB80-206147).

The Employee Benefit Research Institute study analyzed a range of faster vesting alternatives and estimated that faster vesting would increase annual contributions to pension funds from 1.9 to 4.4 percent. For the model plan used in the study, the average annual increase in required contributions to shift from 10-year vesting to immediate full vesting was estimated at about 4.4 percent. A change to 5-year full vesting was estimated to increase annual contribution costs about 2.4 percent.

Section 3032 of ERISA directed the Secretary of Labor to study and report to the Congress, within 2 years after enactment of ERISA, on steps needed to ensure that professional, scientific, and technical personnel and others in associated occupations employed under Federal procurement, construction or research contracts or grants will, to the extent feasible, be protected against forfeiture of pension rights or benefits because of job transfers or loss of employment resulting from termination or modification of Federal contracts, grants, or procurement policies. If the Secretary determined that regulations would be feasible, the Secretary was to develop such regulations within 1 year of the report. Any such regulations were to take effect only if (1) the Secretary delivered a copy of such regulations to the Senate and the House of Representatives not later than 3 years after enactment of the act and (2) neither the House nor the Senate resolved to disapprove such regulations within a 120-day period beginning when the regulations were delivered.

Labor's report to the Congress, "Mobility and Pension Rights of Federal Contract Workers," dated December 30, 1977--about 3 years and 4 months after enactment of ERISA--focused on professional engineers and scientists employed by Federal contractors. ^{1/} The study indicated that the frequency of involuntary pension loss and the amounts lost are small for scientific and engineering personnel. It also indicated that scientists and engineers probably experience losses less frequently than other occupations. Labor's report contained no steps needed or recommendations concerning the loss of accrued pension benefits.

The report stated that Labor would develop regulations, if feasible, in 1978 and that further study would be made on the question of the feasibility of special treatment of pension accruals resulting from Federal contract employment. Labor subsequently determined that regulations dealing only with work on Government contracts would not be a feasible solution because (1) the pension

^{1/}Neither Labor's report nor section 3032 of ERISA specifically addressed service contract workers or the problem of losing pension benefits due to changing employers while continuing on the same job.

portability and vesting problems of the Government contract employees studied did not appear significantly different from those of similar employees in the general population and (2) the employees went back and forth between Government contract work and private work. A Labor official advised us that the problem could best be handled by addressing the issue in the broader context of high mobility in the work force and that Labor was attempting to formulate a comprehensive strategy for resolving the problems associated with portability and vesting. In May 1981, this official said that a comprehensive strategy had not yet been developed and that further action will depend on the policy of the new administration.

The Office of Management and Budget's (OMB's) Office of Federal Procurement Policy is responsible for providing overall direction on procurement policies, regulations, and procedures to Federal agencies. It has not established any policies regarding the pensions of contractor employees who work on Federal installations.

OBJECTIVES, SCOPE, AND METHODOLOGY

The primary objectives of our review were to determine: (1) how Government contracting practices have affected the pension benefits of contractor employees providing services at Federal installations and (2) the extent to which ERISA and the Service Contract Act have protected the pensions of such workers.

We identified 4,017 Federal service contracts with an estimated cost of about \$1.5 billion. These contracts were in effect during 1978 in 13 States. 1/ Contracting agency officials estimated that about 25,000 employees worked on these contracts. We also identified 22 major contracts for the operation of Government-owned facilities. Contract data were provided by 16 departments and agencies 2/ and are believed to include most of the major recurring contracts in the areas covered by our review. Some agencies did not have information on all of their contracts readily available and provided limited data. For example, two agency contracting offices provided data only on service contracts valued at \$100,000 or more. In other cases, data were provided on the amounts of the contracts but not the number of employees.

1/Alabama, Alaska, California, Georgia, Florida, Louisiana, New Jersey, New York, Oklahoma, South Carolina, Tennessee, Texas, and Washington.

2/Departments of the Air Force, Army, Navy, Defense, Energy, Commerce, Transportation, the Interior, Health and Human Services, and Housing and Urban Development; General Services Administration; Environmental Protection Agency; National Aeronautics and Space Administration; Veterans Administration; Small Business Administration; and the Postal Service.

We selected 669 of the 4,017 service contracts to obtain information on pension plans provided (if any). The 669 contracts include 240 contracts which were selected nonrandomly. The nonrandom selection was made primarily from the larger contracts to select contracts for a detailed review of employees' vesting status. We had planned to obtain pension information on the entire universe. However, because this approach took too long, a random sample of 429 contracts was made from the 3,777 contracts remaining in the universe. Although we believe these data are characteristic of Federal service contracts, because of data limitations and our sampling methods they cannot be projected with statistical validity.

For analysis of the pension vesting status of service contract employees we used case study methodology. We selected 16 contracts ^{1/} ranging from about \$34,000 to about \$87.9 million and employing from 11 to 1,918 persons. The 16 contracts had a total estimated cost of about \$274 million and involved about 6,000 employees working at Government installations. Of the 16 contracts, 8 were awarded by the National Aeronautics and Space Administration (NASA). Our universe included 103 NASA contracts, which accounted for about half of the dollar amount and over 40 percent of the employees identified in the total universe.

The data from our sample of 16 contracts are not statistically projectable to the universe of contracts. However, we believe they are generally indicative of the difficulties service contract workers face in retaining benefits because nearly all the contracts were for relatively short time periods and most offered limited potential for retaining pension benefits when changing employers. In addition, the Service Contract Act limits the length of service contracts to 5 years and pension benefits are generally not transferable.

Of the 23 operating contracts, 19 were for operating Department of Energy (DOE) facilities, and 3 were for Army ammunition plants.

DOE contractors usually had operated the facilities for long periods of time. Only four contractors had operated the facilities for less than 14 years, and over half of the contractors had been operating them for from 23 to 36 years. We reviewed the pension status of employees of three contractors where there had been a change in contractors. One contract was not classified by DOE as an operating contract. However, this contract was for services that were formerly performed by an operating contractor.

^{1/}We initially selected 20 contracts. However, four were deleted from our statistical analyses for reasons discussed later in this report. (See p. 12.)

We reviewed the pension status of employees working at one of the three Army installations where there had been a change of contractors. The other two contracts had been held by the same contractors for over 25 years.

Although we only reviewed a few operating contracts in detail, we believe our work was sufficient to draw conclusions regarding the pension status of employees working on the operating contracts in the geographical area we covered and those working for DOE throughout the country because: (1) there have been few changes in operating contractors and (2) DOE has pension protection arrangements which apply nationwide.

Our review included discussions with contractors, pension plan administrators, and employees regarding their pension programs. We also reviewed contractors' and pension plan administrators' records to obtain data on the nature of their pension plans and the extent to which contractor employees were entitled to benefits. In addition to officials of the departments and agencies whose contracts were included in our review, we had discussions with officials of Labor and OMB's Office of Federal Procurement Policy regarding the pensions of service contractor employees.

We also reviewed some studies and reports (see pp. 4 to 7) relating to pensions. We did not attempt to verify the data.

We have not identified the contractors or other non-Federal organizations discussed in this report due to the large numbers involved. Also, some data regarding former contractors were obtained from third parties, such as Federal agencies or current contractors and, although believed reliable, were not verified. The fact that people working on service contracts lost pension benefits due to changes in contractors should not be construed as a criticism of the contractors. Transferability of pension benefits is not a common business practice, and service contracting is a very competitive business. It is costly to protect pension benefits. If Government agencies want pension protection for contractor employees, they have to ask for it and pay for it.

CHAPTER 2

MANY SERVICE CONTRACT EMPLOYEES

UNLIKELY TO RECEIVE PENSION BENEFITS

Many employees working on service contracts at Federal installations will not receive pension benefits because their employers do not have pension plans. Other employees will receive no benefits because they choose not to participate in pension plans. Most employees working on the 16 contracts we reviewed were covered by pension plans. However, 65 percent of these employees did not have a vested right to pension benefits.

While many employees were not vested because they did not work long enough on the same job, a significant number had not vested because their employers changed, even though their jobs did not. We found numerous cases where employees with long periods of service lost pension benefits and will probably lose future benefits because their employers change. Also, employees have received lump-sum payments instead of a right to a future pension. Some spent the payments, and others may not use them for retirement income.

MOST CONTRACTORS DO NOT PROVIDE PENSION PLANS

Service contractors did not provide pension plans to employees on 413 of the 669 service contracts on which we obtained data. These contractors employed about 7,200 of the 20,901 people working on the 669 service contracts. Employees on 130 of the 240 contracts in our nonrandom sample were not provided pension plans. However, only 4,889 of the 16,214 people working on the 240 contracts were not provided pension plans. Service contractors did not provide pension plans on 283 of the 429 contracts in our random sample. About half of the 4,687 employees working on the 429 contracts were not covered by pension plans.

The most common reasons given by contractors for not providing pension plans were (1) they were too costly, (2) Labor's wage determination did not include pension benefits, (3) employee turnover was high, and (4) employees would rather have higher pay than a pension plan.

Even if Labor's wage determination includes pension benefits, contractors may pay the cash equivalent of pension costs rather than providing a pension plan. Contractors chose to pay employees the cash equivalent rather than provide a pension plan for 16 percent of the contracts in our nonrandom sample and 9 percent of the contracts in our random sample. Contractors said they believed it was less costly to make cash equivalency payments.

We interviewed 76 employees receiving cash equivalency payments. Sixty-two percent of them said they preferred the cash to pension coverage, and only 16 percent had established Individual Retirement Accounts.

SOME EMPLOYEES DID NOT
PARTICIPATE IN PENSION PLANS

Employees working under four of the service contracts we reviewed in detail did not participate in pension plans when it would cost them money.

One contractor 1/ hired employees of a prior contractor who paid cash equivalency rather than offering a pension plan. The contractor offered these employees the option of either joining a union-sponsored health, welfare, and pension plan or continuing to receive equivalency pay. According to a contractor official, all but one or two employees chose equivalency pay. Joining the union plan would have cost the employees, who were janitors, about \$100 each per month in equivalency pay.

Employees working on three contracts could participate in pension plans that required employee contributions; however, most did not participate in these plans. Participation rates ranged from 9 to 68 percent.

SERVICE CONTRACT EMPLOYEES
USUALLY NOT VESTED

Only about 5 percent of the employees working under the 16 service contracts could participate in pension plans that provided even partial vesting with less than 5 years of credited service. The most common type of vesting was 10-year cliff vesting, in which employees are fully vested after 10 years of credited service but have no right to benefits with less than 10 years of credited service. Four contractors participated in multiemployer pension plans, 2/ which offer better potential for protecting pension benefits. However, multiemployer plans covered only about 5 percent of the employees working on the 16 contracts.

The service contracts were for 3 or less years, and as shown below, 65 percent of the employees in our sample were not vested although over 29 percent of the nonvested employees had 5 or more

1/This contract is not included in our statistical analyses because we could not obtain data on the vesting status of employees.

2/A multiemployer plan is maintained pursuant to one or more collective-bargaining agreements between an employee organization and more than one employer. Employees can continue to earn credit toward vesting even if they change employers, as long as they work for employers who contribute to the plan.

years of service at the same installation. 1/ The vested employees include employees who are only partially vested and/or those who are only vested with one employer although they also worked for other service contractors. Many vested employees will receive substantially smaller pension benefits than they would receive if all their service contract work were with the same contractor.

Agency	Number of contracts reviewed	Number of employees	Number of employees	Employees sampled		Nonvested employees with 5 or more years of service	
				Employees not vested		Num-ber	Per-cent
				Num-ber	Per-cent		
NASA	8	4,086	1,176	794	68	258	32
Air Force	<u>a/1</u>	1,770	100	30	30	6	20
Other							
Federal agencies	<u>b/7</u>	<u>169</u>	<u>152</u>	<u>100</u>	66	<u>c/7</u>	<u>c/7</u>
	<u>16</u>	<u>6,025</u>	<u>1,428</u>	<u>924</u>	65	<u>c/271</u>	<u>c/29</u>

a/Data were also obtained on another contractor but are not included because: (1) only 50 of the contractor's 702 employees were eligible to participate in the pension plan, (2) only 3 employees participated, and (3) the prior contractor had no pension plan.

b/Three additional contracts were reviewed, but data on them are not included because we could not obtain information on vesting and/or prior employment.

c/This figure is understated because we did not obtain complete data on the length of service for employees working on three contracts. There were several prior contractors, and one contractor went out of business. Of the 63 employees working on the contracts, 34 had transferred from prior contractors. We know from employee interviews that some of the 34 employees had 5 or more years of service.

1/We used 5 years of service because Federal employees are vested after 5 years. As previously noted, service contractors were used in place of Government employees. Also, one of ERISA's minimum standards requires partial vesting after 5 years of covered service.

Although 30 percent of the employees working on the Air Force service contract were not vested, this was not due to changing service contractors. The same contractor had been providing services since 1953. Only 20 percent of the nonvested employees had 5 or more years of service with the current contractor, and most nonvested employees had not worked for other service contractors.

The seven service contracts of the other Federal agencies involved from 11 to 45 employees. Most employees were not long-time workers at the same Federal installation. Employees were generally not vested, but the reasons for their vesting status differed. All 44 eligible employees working on the largest contract were vested even though the agency had only used a service contractor for about a year because the pension plan provided immediate vesting. On the other hand, none of 12 employees working on another contract were vested although some had worked at the installation for several years. Some employees had done the same work for five contractors, but only the current contractor provided a pension plan. Employees of three contractors participated in multiemployer pension plans. These employees can continue to earn credit toward vesting if employers change (and their new employers participate in the multiemployer pension plans).

NASA had a high percentage of nonvested employees working on its service contracts and a relatively high percentage with 5 or more years of service. There was a total of 13 pension plans for the service contract employees working on the eight NASA contracts we reviewed. Most of these plans required at least 6 years of service for even partial vesting.

SERVICE CONTRACT EMPLOYEES HAVE LOST PENSION BENEFITS

Employees working on NASA's service contracts have lost pension benefits because their employers changed. Some employees lost all pension benefits despite long years of service. Others earned full or partial benefits that were paid or may be paid in lump sums, which may not be used as retirement income.

The following four examples show how changes in contractors affected service contract employees.

Example 1

In December 1979, NASA changed contractors for institutional support services. The new contractor replaced a contractor that had provided such services from 1971 to December 1979. That contractor had succeeded a contractor who had performed these services for about 6 years.

The contractor that was replaced in December 1979 had two pension plans for employees. Employees who were members of a union bargaining unit were participants of a company-administered pension plan established exclusively for them (the "H" plan). Salaried and certain other employees participated in a separate plan (the "E" plan). The "E" plan was not limited to employees working on the service contract. Both plans required 10 years of service for vesting.

When the contract expired in December 1979, the "H" plan covered 176 participants, including 163 nonvested employees. The contractor initiated actions to terminate this pension plan. In accordance with termination provisions of ERISA and the Internal Revenue Code, all participants in the "H" plan were to be guaranteed pension benefits. The present value of benefits payable to the 163 nonvested participants of the "H" plan as of December 31, 1979, was \$157,172, ranging from \$23 for an employee in his early twenties with 4 months of service to \$6,058 for an employee in his early sixties with about 8 years of service. The successor contractor hired 144 of these unionized workers and at the time of our review was negotiating with their union to provide coverage under a multi-employer pension plan.

The nonvested participants in the "E" plan were less fortunate. The contractor did not terminate its "E" plan, and these employees lost the value of their accrued pension benefits. At the time of our fieldwork, 7 of the 46 employees in the "E" plan with over 5 years of service were vested. However, all seven were long-time employees of the outgoing contractor, and five of them were expected to continue employment with the outgoing contractor. Of the 39 nonvested employees, 23 had over 10 years of service with the contractor and its predecessor. Many transferred to the successor contractor and became covered by its pension plan for nonunion employees, which has a 10-year service requirement for vesting. Since service with prior contractors does not count toward vesting and the contract covers only 3 years if all options are exercised by NASA, these employees have limited prospects of vesting. Moreover, since they were participants in a pension plan, they could not establish Individual Retirement Accounts.

Example 2

NASA awarded a contract to provide institutional computer systems engineering, development, and production operations covering a 3-year period (including options) starting September 1, 1978. The services had been provided by another contractor for over 10 years.

In May 1979, the contractor had 605 employees, including 338 from the prior contractor. Under the prior contract, all employees were covered by one of two pension plans, both of which required

10 years to vest. The new contractor has two pension plans. Its multiemployer plan for union members requires 10 years to vest. Vesting credit is normally given only for time employed by a contributing employer. None of the 230 employees covered by this plan were vested as of June 1979. The employees who worked for the former contractor were not eligible for past service credit.

The plan for nonunion employees was voluntary, and participants were required to contribute. Vesting started with 20 percent after 6 years of service and 20 percent each year thereafter until 100 percent vested. Credit was not given for service with the prior contractor. Of 333 eligible employees, only 32, including 15 who came from the prior contractor, were in this plan as of May 1979.

We reviewed pension vesting records for all 338 former contractor employees who were working for the new contractor as of May 1979. Only 23 percent of the employees had vested in the prior contractor's plans. Of those not vested, 29 percent had about 5 or more years of service with the prior contractor, including 18 employees with about 8 or 9 years of service.

Because service with the prior contractor was not counted, all of the employees who joined these plans lost credit for their prior service. Since the contract covers only 3 years if all options are exercised by NASA, they will only vest if the contractor obtains follow-on contracts or, in the case of union members, if their future employment is with employers who participate in the multiemployer plan.

Example 3

In 1977, NASA contracted for ground systems operations services for 3 years starting July 1, 1977. Previously, most of the services under this contract were provided under two contracts. One contractor had provided services from October 1964 to June 1977. The other provided services from March 1971 to June 1977. The new contractor was a subsidiary of one of the prior contractors. In mid-1978, there were 1,918 employees working on the contract, of whom about 70 percent came from the two prior contractors.

Both of the prior contractors had pension plans for their employees. One plan required 10 years to vest. The other plan began vesting after 6 years of service.

The new contractor did not provide a pension plan when it started on this contract. Instead, it provided cash equivalency pay based on the cost of pensions provided under the two prior contracts. An official of the new contractor said the company decided that it would be fairer to the employees to provide cash

equivalency pay rather than establish a pension plan because employees had lost pension benefits due to changes in service contractors. He added that some employees had worked 6 years for one company and 7 years for its predecessor.

The contractor established a pension plan effective in January 1978 for employees represented by a union. As of June 1978, 908 of the 1,918 employees under the contract were covered by this plan. The contractor continued to pay cash equivalency to employees not in the plan. The plan normally requires 10 years to vest. Service with contractors at the space center immediately preceding this contract counts for vesting.

We obtained data on 180 employees. Of the 180 employees, 133 had worked for the prior contractors--81 for one contractor and 52 for the other. Half of the 180 employees were participants in the pension plan for union members.

Of the 81 employees working for one prior contractor, 26 had fully vested in its plan and 45 were partially vested. However, because the current contractor is a subsidiary of the former contractor, ERISA requires that service with their current employer be counted for vesting in the former contractor's plan. Thus, nonvested and partially vested employees may become fully vested in the former contractor's plan.

Of the 52 employees in the other former contractor's plan, 36 had vested. Of the 16 employees who did not vest, 7 had 5 or more years of service. A group of 32 employees (not our sample group), with 9 years accrued for vesting when the contract expired, attempted to have the contractor place them on leave of absence long enough to complete their 10th year for vesting. The contractor proposed that NASA provide \$160,200 for the cost of vesting the 32 employees. NASA refused on the basis that its obligation to the pension plan was a matter of contract and paying for additional vesting would not be legal or proper.

Example 4

NASA contracted for aircraft maintenance and modification for 3 years beginning on May 1, 1977. Two other contractors had previously provided these services--one from May 1, 1973, to April 30, 1977, the other for about 10 years until April 30, 1973.

The new contractor had two pension plans, one for nonunion employees and one for union employees. The nonunion plan permitted employee contributions. Employees automatically participated after 1 year of service and were fully vested upon participation. Upon retirement, benefits are to be paid in a lump sum or a fixed number of quarterly installments. Employees who terminate before retirement would receive a lump-sum payment.

The union plan was optional, and participants were required to contribute based on their pay. The contractor's contribution equaled 50 percent of the participant's contribution. An employee could participate after 6 months of service and was 20 percent vested after 2 years. Vesting increased 10 percent each additional year until the employee was fully vested. Service with the contractor who performed services from May 1, 1973, to April 30, 1977, counted toward vesting. Employees who terminate or retire would be paid benefits in a lump sum. Of 132 eligible employees, 84 were participating in the union plan. Eighty participants were partially vested.

Contractor officials said that the prior contractor's plans for both union and salaried employees were similar to its union plan. The contractor's records showed that, of the 100 union employees hired from the former contractor and still employed, 76 participated in the prior contractor's plan and 61 were 20 to 30 percent vested. These officials believed most of the prior contractor's nonunion employees participated in its plan. They said participants received lump-sum payments.

Contractor officials said they knew little about the pension plan of the original service contractor. They believed there was a pension plan for salaried employees and these employees received lump-sum payments.

We interviewed 10 employees who had 10 to 16 years of experience and had worked for all three contractors. All of them participated in the pension plans of the contractor who immediately preceded the current contractor and received lump-sum payments when they terminated. Five of the employees did not participate or only briefly participated in the original contractor's plan. The other five received lump-sum payments. Of the 10 employees, 5 saved the money, 1 saved some, 1 bought real estate, and 3 spent the money. Most of the savers did not plan to use the money for retirement.

CHAPTER 3

PENSION BENEFITS OF OPERATING

CONTRACTOR EMPLOYEES HAVE BEEN PROTECTED

DOE has pension arrangements (see app. I), initiated by the former Atomic Energy Commission (AEC), to protect cost-type contractor employees working at DOE facilities from loss of accrued pension benefits. DOE said that its pension arrangements do not apply to employees covered by the Service Contract Act. However, some DOE contracts to which the pension arrangements apply are similar to what are considered service contracts by other Federal agencies. We reviewed three DOE contracts and found that the pension benefits of employees who went to work for successor contractors have been protected. We also found that one Army command had a policy of encouraging continuity of pension benefits when operating contractors changed.

DOE'S PENSION PROTECTION POLICIES

In 1946, a new contractor began operating AEC's Hanford nuclear complex near Richland, Washington, replacing a contractor which had operated the complex since 1944. According to a DOE official, the contractor that was replaced purchased annuities for its employees that went to work for the new contractor. The new contractor gave credit for service with the prior contractor.

In the mid-1960s, AEC divided the single operating contract into several contracts. At that time, AEC officials at Hanford developed a plan to protect the pension benefits of employees who would become employed by the new contractors. AEC arranged for the purchase of annuities for nonvested employees using the contractor's and the employees' contributions. Employees who withdrew their contributions before vesting in the annuity forfeited it, and the contractor's contributions reverted to AEC.

Successor contractors gave vesting credit for prior service if the employees had vested in the former contractor's plan or the annuity. Employees who withdrew their contributions generally lost vesting credit for their prior service.

AEC subsequently adopted pension arrangements similar to those developed at Hanford as part of its general policy for cost-type operating contracts. DOE has continued these arrangements. The pension arrangement preferred by DOE is that the new contractor continue the prior contractor's plan. If the plan is not continued, other arrangements are made to assure past benefits are protected and prior service is recognized by the new contractor's plan.

DOE officials told us that its pension arrangements apply only to cost-type contracts for operating DOE facilities and that these

contracts are not subject to the Service Contract Act. They said the only significant contracts subject to the Service Contract Act for continuing services are contracts for guards and janitors. The pay and fringe benefits of employees working on these contracts are protected by the Service Contract Act and their unions. Most service contracts are for 1 to 3 years, and the imposition of pension portability would add undue complications and an administrative burden to the contracting process. Also, DOE does not wish to give the appearance of long-term employment or pension responsibility for these mostly transient workers.

They said DOE's pension arrangements for employees providing continuing services at its facilities are appropriate because these contracts are not subject to the Service Contract Act and the work force is more stable. They believed that the practical application of DOE's pension arrangements to service contracts in general was very limited, but that the arrangements did appear applicable to some agency contracts for long-term technical support, such as maintenance and operation of NASA and Department of Defense facilities.

During our fieldwork at Hanford we identified three contracts not subject to the Service Contract Act that appeared similar to some service contracts of other Federal agencies. These were contracts for: (1) occupational health services, (2) architect and engineering services, and (3) computer support services. The same contractor has provided occupational health services since AEC adopted its special arrangements for pension protection. The computer support services contractor changed, and the pension arrangements were applied. DOE plans to apply the arrangements to the architect and engineering services contract if a new contractor is selected.

Pension benefits of contractor
employees at DOE facilities
have been protected

We reviewed the pension status of employees working on three contracts at Hanford by sampling records for 232 employees who had changed employers. In each case, employees received accrued pension benefits and vesting credit for their employment with the prior contractor. ^{1/}

Of the 232 employees, 124 were still employed. All but 3 of the 124 were fully vested in the current contractors' plans. The three, who were partially vested during our fieldwork, if still employed at Hanford, should now be fully vested. Because of the

^{1/}Our report, "Assessment of Pension Benefits for Contractors' Employees in Hanford, Washington" (HRD-81-103, July 8, 1981), discusses in detail how DOE's arrangements have protected pension benefits.

length of time the three contractors had worked at Hanford, all of the employees sampled would have been fully or partially vested at the time of our fieldwork even if service with prior contractors were not counted. However, credit for prior service enabled some employees to quit with a right to future pension benefits. The pension arrangements for employees of the three contractors we reviewed are discussed below.

Example 1

This contractor operated a laboratory and performed other activities with about 2,900 employees. At the time of our review, the contract was to expire on December 31, 1980. However, we were advised that the contractor was awarded a contract, without competition, for 5 more years. This contractor replaced a contractor that had served for about 5 years.

When the present contractor began operations in 1970, it acquired the assets and liabilities of the prior contractor's pension plan for those employees who transferred from the prior contractor. It also recognized employee service with the contractor that operated Hanford from 1946 to the mid-1960s except for employees who withdrew their pension plan contributions.

Since 1976, the current contractor's plan provided partial vesting after 4 years of service with full vesting after 10 years of service. Previously, service toward vesting did not count until the employee was 30 years old, and it took 4 years of credited service to partially vest and 13 years to fully vest.

We reviewed the pension status of 176 employees who came from the prior contractor. As of December 1978, 100 of the 176 employees were still employed and 97 of these were fully vested. The other three employees, if still employed, are now fully vested. Fourteen employees had died, were on leave of absence, or were not active because of long-term disabilities. There were 36 retirees.

Twenty-six employees had quit with a right to receive pension benefits at retirement age. If vesting rights were only based on service with the present contractor, none of the 26 employees would have fully vested and 15 would not have been entitled to any pension benefits.

Example 2

This contractor has provided architect and engineering services since 1963. At the time of our review, the contract was due to expire on December 31, 1980. We were subsequently advised that the contract was extended for 1 year, and there will be competition to determine who provides future services. In February 1979, there were 323 employees working on the contract.

This contractor's pension plan required 10 years to vest. Service with the prior contractor counted toward vesting. We reviewed the status of 26 employees who came from the prior contractor. All 26 had over 10 years of service with the prior contractor and were immediately vested in the present contractor's plan.

Example 3

This contractor has provided occupational health services since 1965. We were advised that the contractor, whose contract was due to expire on December 31, 1979, was awarded a contract for 5 more years, without competition. As of March 1979, 94 employees were working on the contract.

The contractor's pension plan provided vesting with 15 years of service or 10 years of service for employees 35 or more years old. Past service was credited toward vesting except for employees who withdrew their contributions from the prior contractor's pension fund or the annuity established for nonvested employees.

We reviewed the vesting status of 30 employees who came from the prior contractor. All had been given credit for their prior service. Of these, 18 had retired, 1 had died, and 11 were still employed and fully vested at the time of our review.

PENSION BENEFITS OF SOME ARMY OPERATING CONTRACTOR EMPLOYEES HAVE BEEN PROTECTED

Our review included one Army contract for the operation of an ammunition plant. In 1974 the Army selected a contractor to replace the one that had been operating the plant since 1951. The outgoing contractor modified its pension plan to vest all its employees working at the plant regardless of length of service at a cost to the Army of \$431,000. The former contractor's normal vesting schedule provided for vesting with 15 years of service, with 10 years of service at age 40, or at age 60. The new contractor had pension plans which normally required 10 years to vest. Service with the outgoing contractor was credited toward vesting.

The new contractor had 822 employees as of April 30, 1979. Although vesting normally required 10 years of credited service and the contractor had only been operating the plant for about 4 years, about 80 percent of these employees were vested, primarily because service with the prior contractor was counted.

A U.S. Army Armament Materiel Readiness Command official told us that the Command's policy regarding changing operating contractors has always been to encourage successor contractors to make allowance for continuity of service. He provided an example of a similar arrangement at another Army ammunition plant where the new contractor provided continuity of service. Pension funds were transferred from the outgoing contractor to the new contractor.

CHAPTER 4

CONCLUSIONS, RECOMMENDATION, AGENCY

COMMENTS, AND OUR EVALUATION

CONCLUSIONS

There is no overall Government policy regarding whether, or to what extent, Federal agencies should attempt to protect the pension benefits of contractor employees working on Government installations. Some agencies have acted to protect pensions; others have not.

While most employees of the service contractors we reviewed were covered by pension plans, many will not receive any pension benefits from these plans. A significant number of these employees, while continuing to work for many years at the same Government installation, have lost pension benefits because the Government has changed contractors. None of the minimum vesting standards of ERISA require even partial vesting in pension benefits resulting from employers' contributions in less than 5 years. Few employees working on the service contracts we reviewed participated in pension plans which provided any vesting in less than 5 years. Most participants were in plans which required 10 years to vest.

The service contracts we reviewed were usually for 3 years or less. Unless the contractors obtain a number of future contracts, employees are unlikely to vest. Multiemployer plans improve an employee's chances of vesting. However, multiemployer plans were not available to most of the employees working on the service contracts we reviewed.

Quicker or immediate vesting have been suggested to help protect pension benefits. Such changes in vesting have been opposed for several reasons, including increased costs and/or reduced benefits to the long-term employees for whom pensions are intended. Also, quicker or immediate vesting would not necessarily ensure retirement benefits. Opponents of such vesting have claimed that employers would tend to pay in a lump sum the cash value of future pension benefits to terminated short-term employees who may spend the payments rather than saving them for retirement. This was confirmed to a limited extent during our review.

DOE's pension arrangements for operating contractors and the Army's actions on some operating contracts have protected the pensions of long-time contractor employees working at their installations. Some DOE contracts, to which its pension arrangements were or may be applied, appeared similar to service contracts of other Federal agencies.

Protecting the pensions of contractor employees working on Federal installations would increase the Government's costs.

RECOMMENDATION TO THE CONGRESS

If the Congress determines that the pension benefits of contractor employees who work for long periods of time at Federal installations should be protected, we recommend that it direct the Administrator for Federal Procurement Policy to establish a Government-wide policy and implementing regulations to help ensure such protection.

We believe that DOE's pension protection arrangements, which emphasize pension portability and discourage lump-sum payments in lieu of future retirement benefits, provide a good model for a Government-wide policy. We also believe that, to minimize administrative problems, if a Government-wide policy is established, it should be limited to relatively large negotiated contracts where a long-term need for future services is foreseen.

To ensure that any policy and regulations developed are consistent with congressional intent, the Congress could establish oversight provisions.

AGENCY COMMENTS AND OUR EVALUATION

In July 1981, NASA, OMB, and the Departments of Defense and Labor (see apps. II to V) commented on our draft report. Their comments and our evaluation of these comments are presented below. The draft report was also provided to DOE which chose not to comment.

Office of Management and Budget

OMB said its Office of Federal Procurement Policy could establish a Government-wide policy and implementing procurement regulations to help ensure pension protection, if the Congress determined that pension benefits at Federal installations should be protected. It also said that our report showed that Labor had determined that regulations dealing only with Government contract workers would not be a feasible solution because the: (1) pension portability and vesting problems of such workers did not appear to differ from those of similar workers in the general population and (2) employees moved between Government contract work and private work. It said that, although this appears to raise a serious question, our report contains no recommendations to overcome these problems.

We agree that our recommendation does not deal with the portability and vesting problems of the general population or employees working on all Government contracts. This issue is further discussed under NASA's comments.

OMB recommended that the report make clear that contractors are responsible for their employees' pension benefits and the Government should never be responsible in its role as a party to a contract. Accordingly, any policy the Congress considers should carefully protect the Government against claims from contractor employees for unpaid or disregarded pension rights. Such claims should be between the contractor and its employees with employee rights protected by ERISA and other laws.

We agree. Placing the responsibility for developing a pension protection policy and implementing regulations in the Office of Federal Procurement Policy, as we recommended, should ensure proper recognition of OMB's position.

Department of Labor

Labor said its study of Federal contract workers (see p. 6), consistent with ERISA's requirement, focused on professionals and did not look at other contract workers or at the workers on the long-term operational contracts at whom our recommendation is directed.

We do not know what Labor means by long-term operational contracts. Our recommendation is directed at contractor employees who work for long periods of time at Federal installations, including both service and operating contractors. Although we do not believe it is practicable to implement pension protection arrangements where contractors change frequently, our recommendation is not limited to long-term contracts. For example, we believe it could be implemented on 3-year contracts, assuming there is a long-term need for the services being provided.

We have revised the report to clarify the focus of Labor's study. The study is discussed in our report because, if Labor had developed regulations, it is probable that the regulations would have covered the workers who are the subject of our report. Labor's study did include some nonprofessional workers and probably included workers on what Labor considers long-term operational contracts. Labor's study did not attempt to identify the types of Federal contracts on which people worked.

Labor said that only about 35 percent of the workers in our sample were not covered by pension plans, which is better than in the private sector where about 50 percent of full-time workers do not have pension coverage. Also, workers who receive cash equivalency payments instead of pension coverage are better off

than private sector workers who are never offered a similar benefit or mobile workers who are covered by pension plans but will not vest. We agree with Labor.

According to Labor, our report indicated that the average service contract was awarded for 3 years. While some workers stayed at the location when contractors changed, many left voluntarily or were laid off resulting in many nonvested workers. Labor cited statistics, published in December 1979, showing that the: (1) average worker was on his or her current job less than 4 years and (2) median years on the current job was less than 3 years for workers under 35 years of age. Labor concluded that, while the mobility of contract workers may not be entirely voluntary, their job tenure is consistent with that of workers in the general population. Labor said that, despite the discussion in the report, we appear to recognize that short-term service contract workers are not worse off than the general population, since we focus on long-term operational contracts.

Our report does not discuss service contractor employees who lost pension benefits because they changed job locations. It deals with the employees who stayed on the job and went to work for the new contractors. Also, we did not compare the job tenure of Federal contract workers with other workers. While tenure may be comparable, it appears that Labor is comparing the duration of service contracts with the tenure of workers in the general population. The contracts we reviewed were usually for 3 years or less. Several were for 1 year. However, that does not mean that contractors will change with similar frequency. As our NASA examples show, some contractors provided the same services for many years.

Labor said that our recommendation could create difficulties for pension plans. Labor said the proposed arrangement encourages the transfer of service credits and pension funds to successor contractors' plans. Labor said most plans do not have provisions which would permit such transfers. Amendments to plans could be costly and difficult to make without sufficient lead time, especially for collectively bargained plans which tend to be negotiated on a 3-year basis. In some cases, multiemployer plans may not wish to or cannot make the necessary amendments. Labor said that a plan would face substantially increased administrative costs to determine the financial liability for transferred credits.

Although we found instances during our review where contractors had transferred service credit and pension funds, we agree transfers may not always be feasible or appropriate. However, DOE's pension protection arrangements provide alternative methods, such as the purchase of annuities. These arrangements have worked.

Labor said that we discounted the significantly increased costs to the Government that would result from providing earlier vesting for some workers. It noted that two examples in our report showed that the Army paid a contractor \$431,000 to vest its employees, and it would have cost NASA \$160,000 for vesting 32 employees who were 1 year or less short of vesting.

We agree that protecting pension benefits would increase costs; however, the amounts paid by the Army and proposed for NASA are probably not indicative of what pension protection would cost. The Army's contractor vested employees without regard to length of service. Some employees were subsequently terminated without sufficient total service to meet normal vesting requirements. These employees have a vested right to benefits. NASA's records indicate that the amount requested by the contractor included both pension and insurance costs and was computed in a way that resulted in much higher costs than the method used by the contractor in similar situations in the past. Also, both cases involved one-time costs for benefits earned over a number of years.

We are not advocating acceleration of the vesting times specified in pension plans. Implementing our recommendation would result in earlier vesting only in the sense that employees who stay on the job would not lose benefits because contractors change.

Our recommendation is directed toward long-term workers on large contracts. An average of 31 employees worked on the 669 service contracts in our sample, which was designed to assure that larger contracts were included. According to statistics cited by Labor, job tenure of the average worker was less than 4 years. Less than one-third of the nonvested employees in our sample had 5 or more years of service, although nearly all of them were performing services that had been provided by contractors for over 10 years. Thus, we believe that implementing our recommendation would result in increased costs for only a relatively small percentage of the contractor employees working at Federal installations.

Labor also provided more specific wording about the provisions of the Service Contract Act and their applicability to operating contracts and subcontracts. We have made revisions to the report where appropriate.

Labor said that some DOE contracts discussed in our report may meet the criteria for Service Contract Act coverage and urged that we recommend that DOE review the coverage status of all such contracts.

Our review was not directed at determining whether contracts should have been classified as service contracts. We believe it would be more appropriate for Labor, which has primary responsibility for administering the Service Contract Act, to discuss the coverage status of these contracts with DOE.

National Aeronautics and Space Administration

NASA believes that our findings are not limited to Federal contractor employees, but instead are part of a national problem which cannot be solved through Federal procurement policy alone. NASA said it would support a national policy specifically adopted by the Congress and applicable to all companies, rather than only Government contractors. NASA pointed out that, if there were a national policy, it might be more appropriate for other agencies, such as the Department of Labor, to implement and administer it instead of the Office of Federal Procurement Policy.

NASA said that its comments are expressed with caution because of the complex nature of the subject and the need for hard economic data to permit objective dialog. NASA believes that a national policy should not be established without data on costs and benefits.

While we agree that loss of pension benefits is a national problem, we believe actions to reduce the pension benefit losses of contractor employees working on Federal installations need not await resolution of this problem. The Congress has expressed concern about employees working on Government contracts in general and service contracts in particular. Our recommendation offers a way to protect some of these employees. Also, DOE and the Army have already acted to protect contractor employees' pension benefits. A Government-wide policy would help ensure consistency among Federal agencies.

Department of Defense

Defense said it agreed with our recommendation, if it is the will of the Congress. In a draft of this report we stated that the Congress could use language similar to section 3032(d) of ERISA to provide for congressional review and disapproval of any policy or regulations that might be developed by the Office of Federal Procurement Policy. Defense said it believed such review and disapproval procedures were not necessary.

We believe congressional oversight is desirable. It is, of course, for the Congress to decide how oversight should be exercised. Procedures similar to section 3032(d) are one way to achieve this. There are other ways of achieving congressional oversight. For example, our report "Finding Out How Programs Are Working: Suggestions for Congressional Oversight" (PAD-78-3, Nov. 22, 1977) outlines a process for planning and carrying out congressional oversight.

**DEPARTMENT OF ENERGY'S
PENSION ARRANGEMENTS FOR CONTRACTORS**

CONTRACTOR INSURANCE PROGRAMS

AEC Appendix 1401

PART VIII**PENSION AND RETIREMENT PLANS****A. DEFINITIONS (for purposes of this appendix):**

1. **Pension and Retirement Plans.** The terms "pension plans" and "retirement plans" are used interchangeably and mean permanent programs established and maintained by contractors to provide systematically for the payment of definitely determinable benefits to their employees over a period of years, usually for life, after retirement.
2. **Profit-Sharing Pension Plans.** The term "profit-sharing pension plans" means plans providing for the amounts of the employer's contributions to be determined or measured by the employer's profits or earnings. The future benefits cannot be actuarially determined since it is not possible to furnish any assurance that sufficient funds will be available at any time to meet any particular schedule of benefits. Such a plan may constitute the sole pension arrangement of a contractor or it might be superimposed upon or be an addition to a moderate actuarially sound pension plan providing only for pension benefits within cost limits that the contractor is willing or able to meet as a recurring fixed obligation.
3. **Past Service Costs.** The term: "past service costs" is the amount at any time actuarially determined which would be required at such time to meet all the future benefits provided under the plan which would not be met by future normal costs and employees contributions with respect to the employees covered under the plan at such time. The term includes "supplementary costs" defined below, costs attributable to service prior to the date of the establishment of a plan or a major amendment thereto and additional costs in particular years resulting from a change in the funding method.
4. **Supplementary Costs.** The term "supplementary costs" covers a variety of special benefits in addition to the principal or regular benefit credits. An example is the credit for service from the date an employee commences working for an employer and the date he becomes eligible for participation in the plan. The costs of such

credits may be determined only as the conditions are fulfilled and the credit matures for individual employees.

5. **Vesting.** The term "vesting" means the attainment by a participant in a plan of certain rights in the funds arising out of the employer's contributions made in his behalf. The rights ordinarily are granted only after certain requirements of the plan are met such as the completion of a specified number of years of service and/or attainment of a particular age.
6. **Replacement Contractor.** A replacement contractor is a cost-type contractor who enters into a contract with the AEC for the purpose of performing all or part of the management and operation of an AEC-owned facility or function previously managed and operated by an AEC cost-type contractor.

B. TYPES OF PENSION AND RETIREMENT PLANS

Basically, pension and retirement plans are classified as either trusteed plans or annuity plans although there may be a combination of both. Under the trusteed type, the contributions are paid into a separate fund established by a trust indenture and direct payments are made to the beneficiaries. Under the annuity type, the plan benefits are insured with an insurance company which issues either group or individual contracts. A form of group annuity contract called "deposit administration" provides for the accumulation of premiums in a deposit fund and, upon retirement, for the withdrawal of the amount necessary for the purchase of an annuity to provide for the employee's pension benefit.

C. SPECIAL PENSION ARRANGEMENTS FOR AEC OPERATING CONTRACTORS

1. Special financial arrangements are usually required in the case of pension and retirement plans of cost-type contractors operating AEC-owned facilities to accomplish the following objectives:
 - a. To assure that the pension cost to AEC approximates the actual cost to the contractor for the period of the AEC

Approved: May 7, 1974 1/

SOURCE: DOE.

1/DOE officials were revising this appendix as of May 1981. DOE officials also told us that no significant changes were planned.

AEC Appendix 1401
Part VIII

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- contract for those contractor employees in whom pension rights vest.
- b. To plan where feasible that contractor employees do not lose or forfeit accrued pension benefits solely on account of a change of AEC contractors. However, the benefit provided under each contractor's plan will be calculated solely on remuneration and length of service with that contractor.
 - c. To protect the financial interests of the various parties, i.e., the AEC, the employees, and the Contractor, in the event of termination of the project.
 - d. To assure that employees retired from AEC contract work will be granted cost of living increases comparable to those granted retirees from the contractor's commercial work during the active term of the contract.
2. Preferred Arrangements. The most satisfactory arrangements to accomplish the above objectives are those that:
- a. provide that the pension funds for the contractor's employees at an AEC facility be separate from any other fund.
 - b. provide where feasible that the plan may be transferred to and continued by a replacement contractor. Other arrangements could be considered such as assignment and continuation of the plan by someone other than the replacement contractor; creation of a new but identical plan to purchase, at vesting by combined service, paid-up annuities equal to benefits actually accrued at time of transfer; and using released liabilities to "buy" benefits under the retirement plan of the replacement contractor for the period of prior contractor service.
 - c. provide that, if any replacement contractor does not adopt the plan of the outgoing contractor and payments for future service under it are discontinued, the fund will remain intact to the extent required, based upon actuarial determination, to furnish accrued benefits for employees who continue work at the facility, and discontinuance of payments for future services shall not constitute a termination of the plan. Also, provide that this fund be used to furnish such employees with retirement benefits representing service with the prior contractor in accordance with the provisions of the plan when their combined service with the contractor and with prior and replacement contractors is sufficient to meet the vesting requirements.
 - d. provide that in the event of a contractor replacement, employees employed by the replacement contractor forfeit the option of early retirement from the former contractor. This should be considered mandatory for plans covering AEC work only.
 - e. provide for the credit or payment to AEC of any excess funds.
3. Minimum Arrangements. Where it is not practicable or possible to make the above arrangements and a company-wide plan is adopted for the contractor's personnel at the AEC facility, the following will be the minimum arrangements which the AEC will consider satisfactory:
- a. A provision for separate accounting or separate funding for the AEC facility for costs incurred under the contract.
 - b. A provision that, in determining AEC costs, AEC will be credited with its proportionate share of the earnings of the Corporate Pension Fund, including unrealized appreciation in the value of Fund's investments.
 - c. A provision for the return to the AEC of any excess funding and other credits (including forfeitures). Particular attention must be given to protecting the AEC's interest where the contractor's contributions (which are reimbursed by the AEC) are made on behalf of the employees who transfer to the contractor's commercial operations and whose employment is subsequently terminated before vested rights in the plan are acquired.
 - d. A provision that, in the event of contractor replacement, the contractor will assist the AEC in preserving employees opportunities to attain vested rights through continuity of service with the replacement contractor at the AEC facility. For example, in a contributory plan, all employees who have not met the vesting requirements of the contractor's plan at time of

CONTRACTOR INSURANCE PROGRAMS

employment by the replacement contractor will be encouraged to make the accumulations of their own contributions available to be combined with AEC funds for the purchase of annuities consistent with the provisions of the pension and retirement plan for the periods of their participation therein.

- a. A provision that, in the event of contractor replacement, the retiring contractor will not voluntarily grant early retirement to employees employed by the replacement contractor.
4. **Reporting Requirements.** An annual accounting and an annual actuarial valuation are required for AEC review and information and should be submitted to the Division of Labor Relations within 6 months after the end of the plan year.
 - a. The accounting reports should include at least the following items:
 - (1) the amount of the fund at the beginning of the year.
 - (2) employee contributions (if applicable).
 - (3) employer contributions.
 - (4) income (earnings, etc.).
 - (5) pension and other benefit disbursements.
 - (6) expenses incurred during the year.
 - (7) fund balance at the end of the year.
 - (8) total number of contract employees.
 - (9) total number of pension plan participants.
 - b. The actuarial valuations should include at least the following items:
 - (1) a description of any adjustments for actuarial gains and losses, including unrealized appreciation and depreciation in the value of investment.
 - (2) a summary of the most recent actuarial valuation of the plan, including the actuarial assumptions, the value of the vested benefits, the cost methods employed, and a summary of the plan.
 - (3) suggested contribution for the ensuing year.
 5. **Total and Partial Pension Plan Termination**
 - a. The immediate vesting of accrued benefits generally will be required if

upon contract termination the pension plan is terminated and there is no replacement contractor. The immediate vesting of accrued benefit may or may not be required in other situations depending upon whether or not the termination or partial termination of the pension plan is determined to have occurred. For example, where a replacement contractor has a comparable plan or takes over the terminating contractor's plan, the latter will not be considered to have been terminated. However, should a reduction in force be involved, with or without contract termination, a partial termination of the pension plan may have occurred. These and similar situations require the pension plan status to be determined on a case-by-case basis after a careful review of all of the pertinent circumstances.

- b. Arrangements will be negotiated to provide a hedge to fluctuations in the cost of living through investment in equity securities or through variable annuities. Where such arrangements require additional costs, the matter will be referred to Headquarters for resolution along with the request for approval of the final termination arrangements.
6. **Arrangements with the Replacement Contractor**
 - a. Special arrangements are usually required in advance when AEC replaces one operating contractor with another. Care must be taken to protect those employees who continue to work with the replacement contractor from loss or forfeiture of accrued pension benefits currently earned under AEC contract work but not yet vested. Also, care must be taken to avoid giving duplicate benefits solely on account of a change of contractors. The ideal arrangement is one where the replacement contractor takes over the prior contractor's pension plan for both past and future service.
 - b. If the replacement contractor cannot continue the prior contractor's pension plan for future service benefits, the replacing plan should meet the same requirements and conditions as set forth in C.2. or C.3., above. In addition, the

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replacement contractor should provide that:

- (1) The employees' years of service with the prior AEC contractor will count as service toward the participation requirements of the replacement contractor's plan, and also toward any length of service requirements for benefit eligibility (for example, for vesting, early retirement, or disability retirement) under the plan. Prior service will not be credited where the transferring employee at any time elects early retirement under the prior contractor's plan.
- (2) When the employee's combined service meets the vesting requirements under the prior contractor's pension plan, or at retirement, the replacement contractor will provide for the benefit of such employee an annuity in an amount equal to the benefits earned under prior contractor's pension plan unless otherwise provided by the prior contractor. The provision of such annuity shall be made at the time and under an arrangement mutually agreed upon between the replacement contractor and the AEC.
- (3) Except, as otherwise agreed by AEC, any employee electing early retirement under the prior contractor's pension plan shall not be employed by the replacement contractor.
- (4) In the case where the predecessor's pension plan was a contributory plan and the nonvested employees are to be refunded their contributions and earnings thereon, such employees shall be encouraged to make their refunds available for the purchase of annuities consistent with the provisions of the pension plan in effect during the periods of their participation therein.
- (5) An employee not making his refunds available shall forfeit all rights to any contributions made in his behalf by the prior contractor and any credit for his service with the prior contractor towards

participation and vesting under the replacement contractor's plan.

7. **Insured Plans.** When an operating contractor proposes to purchase an insured pension plan to cover his employees on AEC work, he should solicit proposals from a sufficient number of insurers to establish adequate competition taking into consideration expected cost, guarantees, and other pertinent factors.
8. **Exceptions.** Exceptions to the above require approval of the Director, Division of Labor Relations. It is recognized that there may be a small group of employees for whom separate retirement or pension arrangements are equitable because of either past or future service with the contractor in its private operations. Such arrangements are permissible and should not be treated as exceptions.

D. AEC APPROVAL OF PENSION AND RETIREMENT PLANS

1. **Purpose.** The purpose of requiring AEC approval is to determine that AEC's financial interests in the plan are continuously protected; that is, that the method to be used for funding the plan, the actuarial assumptions and method to be used to compute liabilities of the plan, and the estimated costs are reasonable by AEC standards.
2. **Responsibility for Approval.** In the following cases, pension plans, amendments to the plans, and changes in methods of funding must be submitted to the Division of Labor Relations for approval:
 - a. Where the contractor operates an AEC-owned facility.
 - b. Where an AEC contract is being performed at a contractor's plant or facility and the contract work involves the full-time use of not less than 50 percent of the total number of the contractor's employees at such plant or facility.
 - c. Where an AEC contract is being performed at a separate plant or facility of a contractor with a definite segregation of personnel working on the AEC contract.

CONTRACTOR INSURANCE PROGRAMS

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In all other cases, the plans, amendments and changes in methods of funding may be approved by the managers of field offices on the basis of the criteria set forth in this part VIII. All pension and retirement plans requiring Headquarters approval, together with all supporting data, shall be forwarded to the Division of Labor Relations which shall authorize appropriate action on the plans to the field office manager.

3. Requirements for Approval

- a. Where a contractor is subject to Federal income taxes, the plan shall have received the approval of the Internal Revenue Service or, if the plan is being considered for IRS approval, the action of the AEC will be conditioned upon receiving such approval.
- b. Where a contractor is not subject to Federal income taxes and the approval of the Internal Revenue Service is not obtained, the AEC will include the following criteria in determining the acceptability of a plan:
 - (1) There must be a formal written document communicated to the employees as a permanent pension program providing for payments to be made into a trust or a group annuity contract.
 - (2) The plan must be for the exclusive benefit of the employees or their beneficiaries.
 - (3) The benefits must be reasonable.
 - (4) The plan must not discriminate in favor of officers, stockholders, supervisory or other highly-paid employees.
 - (5) Until the purposes of the plan have been fulfilled, it must be impossible for the principal or income of the plan to be diverted for any other purpose. (In the case of contractors operating AEC facilities, special arrangements will be required for the return of any excess funds to AEC.)
 - (6) A pension trust may not engage in certain transactions with the creator of the trust or a party controlled by or closely related to the creator which result in benefits to the creator or related party.

c. Plans operated for manual employees in the construction industry under agreements between employers and labor unions in the general project areas and plans established by the statutes of the various states ordinarily will be considered for approval by the AEC without reference to the Internal Revenue regulations and rulings.

d. Profit-sharing pension plans may be considered for approval by the AEC provided they:

- (1) constitute a bona fide pension program; i.e., the primary purpose is to provide pension or retirement benefits at a specified retirement age (as distinguished from an arrangement for the distribution of profits to the contractor's officers and employees).
- (2) contain a fixed method for the determination of the amount of the contractor's contributions.
- (3) contain a definite method for the application of the contractor's contributions for pension benefits of the employees.
- (4) meet the other pertinent requirements of this chapter and appendix.

e. Pension plans vary greatly as to the benefits to be provided and also as to provisions for vesting of rights and equities, eligibility requirements, methods of funding, retirement ages, etc. Regardless of approval by the Internal Revenue Service, where a plan contains provisions for benefits beyond the scope of a bona fide pension plan such as for deferred compensation to be paid to the employees before retirement, the plan may be approved subject to the test of reasonableness of total compensation.

f. Any questions regarding the propriety of any financial provisions of a plan should be submitted for the consideration of the Director, Division of Labor Relations.

E. PENSION COSTS

1. Allowability. In the negotiation of contract terms concerning pension arrangements, in the negotiation of pension plan terms, and where the terms thereof provide for AEC

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approval in the administration of pension arrangements, pension costs may be allowed in all or appropriate part as contract costs subject to any special contract provision, the test of reasonableness, the application of generally accepted accounting and actuarial principles and practices, and the following provisions of this section. (In the event that the contractual terms differ or are inconsistent with the principles stated herein, the contractual terms prevail. See AECPR 9-15.5003 for approval of deviations in contract terms.)

2. **Funding.** Before the contributions required to be made under a plan may be considered for allowability as part of the cost of an AEC contract, they must have been deposited in the pension trust, paid to the insurer, or paid to the pensioner.
3. **Reasonableness.** Ordinarily, if the employer's contributions under a pension plan for normal costs and past service costs are determined by an independent actuary, and are acceptable by the Internal Revenue Service, they may be considered as reasonable. However, normal costs, together with all other compensation paid to the employee shall be reasonable in amount. Compensation is considered reasonable to the extent that the total amount paid or accrued is commensurate with compensation paid under the contractor's established policy and conforms generally to compensation paid by other firms of the same size, in the same industry, or in the same geographic area, for similar services. (See AECPR 9-15.5010-14.) The above criteria is also applicable to the profit-sharing pension plans.
4. **Past Service and Supplementary Costs**
 - a. Past service costs that have been actuarially funded by the contractor may be allowed for contract cost reimbursement purposes to the extent allowable by the Internal Revenue Service for Federal income tax purposes, i.e., not in excess of 10 percent of the past service cost annually. In the case of operating contracts, the 10 percent rule will be applicable only if found to be reasonable under the circumstances in

the particular case. Past service costs are often spread over a period represented by the difference between normal age of retirement and average age of the participant. Such costs at the beginning of such contracts normally will be only those with respect to transfers to the AEC project from the contractor's other operations and will be considered in the negotiation of the special pension arrangements; thereafter, the costs incurred by reason of plan changes in benefits or methods of funding, etc., will be considered in the review of such changes by the Division of Labor Relations.

- b. In some cases, a contractor may defer the funding of past service and supplementary costs of a plan but still meet the requirements of the Internal Revenue Service as to the reasonableness of each year's contribution by paying interest on the unfunded amount. Such interest is considered as part of the pension cost rather than as a financing charge and, therefore, may be accepted to the extent that for any one year the amount paid does not exceed the amount that would have been allowed if the past service or supplementary cost had been funded. The same rule is applicable in the case where interest and part of the annual past service cost is paid.

F. CREDITS

1. **Accounting For Credits** Credits arise in various ways and it is essential that proper accounting be made for all credits arising from payments reimbursed by AEC. Credit for the normal turnover of the participants under a plan ordinarily is included as a discount factor in the actuarial computations of the annual contributions. Adjustment need be made only for forfeitures which directly or indirectly inure to the benefit of the contractor; forfeitures which inure to the benefit of other employees with no reduction in the contractor's costs will not normally give rise to adjustment in contract costs. (See AECPR 9-15.5010-14(k)(3).) However, substantial credits for which special provision should be made arise in cases such as the following:
 - a. Where there is a mass termination of

CONTRACTOR INSURANCE PROGRAMS

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- AEC project employees.
- b. Where an AEC project is terminated or there is a change in the contractors at the project with the consequent termination of the pension plan.
 - c. Where a contractor substantially expands his organization for the performance of an AEC contract and there is reasonable expectation that all or a large number of the additional employees will not receive the plan benefits. In such circumstances special arrangements shall be made with the contractor for the recapture of forfeitures whether or not they inure to the benefit of the contractor.
2. Methods of Providing for the Credits. Three principal methods are available for the protection of the AEC's interest in the credits, although in some particular case some other method may be found to be more satisfactory. These methods are as follows:
- a. The actual cost method is that employed in connection with the special pension arrangements for AEC operating contractors (see C., above).
 - b. Under the recapture method the contractor, pursuant to an appropriate contract provision, is required to make a refund of any credits which are to be determined within some specified time such as one year after completion or termination of the contract.
 - c. Under the discount method, the amount of the contractor's current costs is discounted by a percentage agreed upon by the AEC and the contractor. The contractor's allowable pension costs under this method would be determined on the basis of the proportion of the employees who are expected to participate in the plan benefits to the total number of employees for whom contributions are being made with due consideration being given to any other pertinent factors such as normal employee turnover and the time of acquisition of vested rights in the plan.



EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

JUL 20 1981

Mr. William J. Anderson
Director, General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This is in response to a GAO draft report entitled "Pension Benefit Losses of Contractors' Employees Working at Federal Installations Can Be Reduced" which was furnished to OMB for comment prior to final issuance.

The draft report suggests that it may be desirable to protect pension rights of employees of Government contractors in situations where the Government decides to change contractors and employees of the old contractor continue on under the new contractor. The report recommends that if the Congress decides to adopt such a policy, it place implementing responsibility in the Office of Federal Procurement Policy.

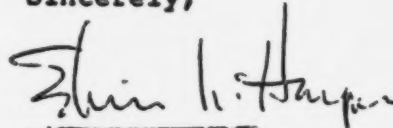
We recommend that the report make clear that pension benefits of contractor employees are a responsibility of the contractor. They are not now, and never should be, a responsibility of the Government in its role as a party to a contract. Accordingly, any policy the Congress considers should carefully protect the Government against claims from contractor employees for unpaid or disregarded pension rights. Such claims should be between the contractor and his employees with employee rights protected by the Employee Retirement Income Security Act and other laws.

Further, the draft report notes that the Department of Labor has determined that regulations dealing only with work on Government contracts would not be a feasible solution because (1) the pension portability and vesting problems of the Government contract employees studied did not appear significantly different from those of similar employees in the general population and (2) the employees went back and forth between government contract work and private work. This appears to us to raise a serious question, yet the draft report contains no recommendation with respect to overcoming these problems.

If the Congress were to determine that the pension benefits at Federal installations should be protected, OFPP could establish a Government-wide policy and implementing procurement regulations to help ensure such protection.

Thank you for the opportunity to review the draft report. We look forward to receiving the final report.

Sincerely,

A handwritten signature in dark ink, appearing to read "Edwin L. Harper". The signature is fluid and cursive, with the first name "Edwin" and last name "Harper" clearly distinguishable.

Edwin L. Harper
Deputy Director

U.S. Department of Labor

Assistant Secretary for
Labor-Management Relations
Washington, D.C. 20210



17 JUL 1981

Mr. Gregory J. Ahart
Director
Human Resources Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

This is in reply to your letter to Secretary Donovan requesting comments on the draft GAO report entitled, "Pension Benefit Losses of Contractors' Employees Working At Federal Installations Can Be Reduced." The Department's response is enclosed.

The Department appreciates the opportunity to comment on this report.

Sincerely,

Ronald J. St. Cyr
Deputy Assistant Secretary
Labor-Management Relations

Enclosure

GAO note: Page and paragraph numbers have been changed to agree with the final report.

U.S. Department of Labor's Response to
The Draft General Accounting Office Report
Entitled --

Pension Benefit Losses of Contractors'
Employees Working at Federal Installations
Can Be Reduced

Recommendation

"If the Congress determines that the pension benefits of contractors' employees who work for long periods of time at Federal installations should be protected, GAO recommends that it direct the Administrator for Federal Procurement Policy to establish a Government-wide policy and implementing regulations to help ensure such protection. GAO believes that the Department of Energy's pension protection arrangements which emphasize pension portability and discourage lump-sum payments in place of future retirement benefits would provide a good model for such a policy. To minimize administrative problems, if such a policy is adopted, it should be limited to relatively large negotiated contracts where a long-term need for future services is foreseen."

Comments

Section 3032 of the Employee Retirement Income Security Act (ERISA) required the Department of Labor to study the problems of "professional, scientific, and technical personnel and others in associated occupations employed under Federal procurement, construction or research contracts or grants..." in protecting their retirement rights or benefits. Section 3032 also allows the Secretary of Labor to promulgate regulations to protect the retirement rights of contract employees.

The Department conducted the required study and submitted a report to Congress on December 30, 1977. Consistent with the statutory requirement, the study focused on professional contract workers. The report examined the mobility, pension plan coverage rates and effects of layoff on the pension rights of engineers and scientists engaged in Federal contract work. The report found that engineers and scientists engaged in Federal contract work had a higher rate of pension plan coverage than those not involved in contract work. As a result of the higher coverage, it also found that the proportion of those laid off from contract work who experienced pension loss was somewhat higher than those laid off from non-contract work.

Based on the findings of the report, the Secretary of Labor determined that the potential pension losses of professional contract workers were not significantly different from the non-contract population. Therefore, special regulations concerning only contract workers' were not written by the Department of Labor.

The DOL study did not look at other contract workers or workers in long-term operational contracts. However, the GAO recommendation is aimed at the group of employees in long-term operational contracts which were not looked at under the DOL study.

While the DOL study does not provide detailed information directly related to the GAO recommendation, it is helpful in understanding that different types of government contract workers reflect different pension problems, and that making any general recommendation is difficult. Before we discuss the GAO recommendation which only affects the limited group of workers in long-term contracts, some general comments on pension plans for all workers and their relationship to government contract workers are necessary.

A discussion of the lack of pension protection for service contract workers is a major part of the GAO report. According to the GAO data, approximately 35% of these workers are not covered by pension plans. This is better than in the private sector where approximately 50% of full-time workers are not covered by pension plans. In addition, a proportion of the non-covered contract workers were receiving a cash equivalency payment in lieu of participating in a pension plan. The workers who receive these payments could, if they wished, generally contribute up to the lesser of \$1,500 or 15% of compensation to an individual retirement account (IRA). Workers who receive this cash equivalency, whether or not they establish an IRA, are better off than many workers in the private sector who are never offered a similar benefit. They even have advantages over similarly mobile workers in the private sector who are in plans but will never vest. According to data derived from a computer simulation developed by Brandeis University, 60% of men and 80% of women who change jobs are not vested. The model estimated that 25% of these workers will lose benefits valued at \$500 or more but that over 50% will lose benefits of less than \$250. Thus contract workers with cash equivalency payments receive a greater benefit than these workers who will receive nothing.

GAO indicated that the average service contract was awarded for three years. While some workers stayed on the location even though the contractor changed, many left voluntarily or were laid off. This resulted in a large number of non-vested workers and workers who lost benefits because of inability to vest. In December 1979, the Monthly Labor Review published statistics which showed that the average worker had been at their current job less than four years. In fact, the median years on the current job is less than three years for workers under the age of 35. While the mobility of contract workers may not be entirely voluntary, their job tenure is consistent with that of workers in the general population.

Despite the discussion in the report, GAO appears to recognize that short term service contract workers are not worse off than the general population, since it focuses on long term operational contracts. GAO's recommendation is to the Office of Federal Procurement Policy and not the Department of Labor. Since the Department is not the target of the recommendations, we will limit our comments on the recommendations to certain difficulties such arrangements could create for pension plans. The proposed arrangement encourages the transfer of service credits and pension funds to successor contractor plans. This could cause serious administrative problems for the successor plans as well as significantly increase Government contract costs.

Most plans do not have provisions which would allow them to accept these credits or funds. Amendments would need to be made to the plans; such amendments could be costly and difficult to make without sufficient lead time. The difficulties would be most acute in collectively bargained plans which tend to be negotiated on a three year basis. In some cases where multiemployer plans are involved, they may not wish to, or cannot, make the necessary amendments. Once a plan is amended to accept such credits it will face substantially increased administrative costs in determining the financial liability for transferred credits.

The recommendation also tends to discount the significantly increased costs to the Government in accelerating the vesting of workers in terminated contracts. The two examples given in the study seemed to indicate the Army paid \$431,000 to an outgoing contractor to vest its employees and NASA would have paid \$160,000 to vest 32 employees who were one year or less short of vesting. The cost to the Federal Government of such a Government-wide policy that would require extra payments above ordinary contract costs in order to provide earlier vesting for some workers would be substantial.

Other Comments

The Department suggests that the discussion of the Service Contract Act in the report be revised as follows to more accurately reflect the requirements of the Act and the Department's interpretations thereunder.

Page 1, fifth paragraph, first sentence should read:

The act, as amended, covers all persons except bona fide executive, administrative and professional employees who perform contract services on contracts principally for services through the use of service employees.

Page 1, fifth paragraph, second sentence:

The Department of Labor, which administers the act, has determined that employees of prime contractors which have been delegated the responsibility for all work to be done in connection with the operation and management of a Government facility on a cost-reimbursable basis, together with the authority to obligate Government funds in the procurement of all services and supplies necessary to carry out the entire program of operation (so-called GOCO contracts), are not subject to the act.

Page 1, sixth paragraph, last sentence should read:

"...in the locality, or based on collectively bargained rates of the predecessor contractor, if any."

The next paragraph should point out, in addition to the statements therein:

If the contractor elects to provide the pension benefit by payment to a third party there is no requirement that the employee ever vest in a pension for the Act's requirements to be satisfied, provided that the contractor does not recoup any portion of the payment. Nor do the regulations require that the contractors permit any employee to elect cash or an equivalent benefit in lieu of contributions to a pension fund, even where it is unlikely that an employee will ever vest in the pension benefits.

Page 2, second paragraph, second sentence, should read (necessary because other procurement statutes may prohibit multi-year contracts);

The act permits service contracts to be awarded for up to five years

Page 2, third paragraph, last two sentences:

As discussed above, the Department of Labor has determined that operating contracts meeting certain requirements are not subject to the act. However, service contracts awarded by operating contractors would be subject to the act under any circumstances.

We note with respect to the operating contracts that in several instances the GAO report comments that some such contracts awarded by DOE are "similar to what are considered service contracts by other Federal agencies" but nevertheless do not contain Service Contract Act provisions. Of particular interest are three DOE contracts at the Hanford nuclear complex discussed on page 19. It appears from page 18 of the report that these contracts, for occupational health services, architect and engineering services, and computer support services, respectively, were among several created by the division of a single operating contract into several contracts in the mid-1960s. The prior operating contract seems to have been a GOCO contract not subject to the SCA under the principles in 29 CFR 4.107(b). However, on the basis of the limited information contained in the draft report, it appears that the several individual contracts awarded in place of the single operating contract may meet the criteria for SCA coverage. Accordingly, we urge that GAO recommend to DOE that the SCA coverage status of all such contracts be reviewed in accordance with Regulations, Part 4; and the principles set forth above.

Finally, we would like to point out that we are unaware of the origins of the figures on page 1 of the GAO report regarding the number of employees subject to the SCA and the cost of SCA - covered contracts. Based on current figures citing OMB as a source, there are 1 - 1.5 million workers subject to the SCA on contracts costing approximately \$10 billion. (See GAO note.)

GAO note: The figures referred to have been deleted from the final report.



National Aeronautics and
Space Administration

Washington, D.C.
20546

Reply to Attn of L

JUL 2 1981

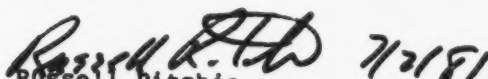
Mr. Gregory J. Ahart
Director
Human Resources Division, Room 6864
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Ahart:

Thank you for the opportunity to review GAO's draft report entitled, "Pension Benefit Losses of Contractors' Employees Working at Federal Installations Can Be Reduced", Code 207280. The report has been staffed through appropriate NASA management.

Because of the complex nature of this important subject, our enclosed comments are expressed with caution. We believe that additional data and objective dialogue are necessary before final policies can be implemented.

Sincerely,


Russell Ritchie
Deputy Associate Administrator
for External Relations

Enclosure

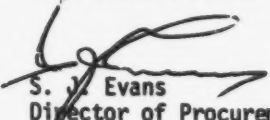
cc: GAO/Mr. Walton Sheley, Jr.

GAO Draft Report
Pension Benefit Losses of Contractors' Employees
Working at Federal Installations
Can Be Reduced
(207280)

This responds to the GAO request of June 8, 1981, seeking NASA comments on draft report 207280.

NASA does not take issue with the general findings contained in the GAO report pertaining to some contractor employees' loss of pension benefits resulting from job transfers or loss of employment due, in part, to the competitive nature of awarding Federal contracts. Although we appreciate the problems expressed in the report, we do not believe that such findings are limited to Federal contractor employees. Further, due to the national implications governing the subject of pension benefits, in our view an equitable solution cannot be achieved through Federal procurement policy alone. NASA would be supportive of a national policy specifically adopted by the Congress and applicable across the board to all companies, not just those electing to contract with the Federal Government. Assuming adoption of such a national policy, existing agencies having ERISA authority such as the Department of Labor (rather than the Office of Federal Procurement Policy) may be the more logical choice for implementation and administration.

NASA also believes that before a national policy is established, some form of cost/benefit study should be undertaken. We are against establishing a policy of this magnitude without some indication of the total cost involved, both to the private sector and to the Government. Since NASA is unaware of the potential cost impact of the various pension proposals contained in the draft report, it seems prudent to approach this complex and important subject with caution until hard economic data is available to permit an objective dialogue.


S. J. Evans
Director of Procurement



RESEARCH AND
ENGINEERING

THE UNDER SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

17 JUL 1981

Mr. Walton H. Sheley, Jr.
Director, Mission Analysis and
Systems Acquisition Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Sheley:

We appreciate the opportunity to comment on your draft report entitled "Pension Benefit Losses of Contractors' Employees Working at Federal Installations Can be Reduced" (OSD Case #5725). We concur in your recommendation that if it is the will of Congress to protect the benefits of contractors' employees who work for long periods of time at Federal installations that the Office of Federal Procurement Policy should establish a Government-wide policy to ensure such protection. However, in the event that Congress acts on your recommendation, we do not believe it would be necessary for Congress to establish review and disapproval procedures.

Sincerely,

James P. DeLoach
for Richard D. DeLoach

(207280)